




Shell Exploration & Production Company

One Shell Plaza
P. O. Box 2463
Houston, TX 77252-2463

October 13, 2000

Department of the Interior
Minerals Management Service
Mail Stop 4024
381 Elden Street
Herndon, VA 20170-4817

RULES PROCESSING TEAM

OCT 16 2000

Attention: Rules Processing Team

Subject: MMS Request for Comments on Proposed Rule for Issuing OCS Leases after November 2000 with Royalty Suspensions (65 FR 55476 – 55489)

Dear Sir or Madam:

On behalf of Shell Exploration & Production Company, I am pleased to respond to the September 14, 2000 *Federal Register* notice from the Minerals Management Service (MMS) requesting comments on the Proposed Rule for issuing Outer Continental Shelf (OCS) leases after November 2000. This letter highlights Shell's views regarding the Proposed Rule.

In broad context, the Proposed Rule should focus on providing meaningful incentives to high cost/high risk economically marginal exploration and production opportunities that would not be developed absent royalty relief. The regulations should be as simple and straightforward as possible in order to expedite the decision making process and ease the administrative burden to the maximum extent practical. The guidelines should reward companies who are efficient and who commit to the development of resources. Properly structured, royalty relief can offer a win-win opportunity for government and industry by stimulating needed domestic natural gas and oil production.

Ultra-Deep Water Relief

Shell believes the focus of royalty relief should be on providing meaningful incentives for ultra-deep water leases in water depths greater than 1500 meters. Shell encourages the MMS to further delineate the relief by providing increasingly higher royalty suspension volumes with increasing water depth to encourage exploration and development in ultra-deep water. Exploration and development activities in these water depths carry increased financial risk and technological challenges. These risks and challenges include but are not limited to reservoir connectivity, reservoir performance, limited production experience, rig availability, rig price fluctuations, need for new and innovative technology, distance from support infrastructure, higher development costs and shallow water flow. Should MMS elect to offer royalty relief in shallower waters, we believe leases offered in water depths greater than 1500 meters should

receive the greatest royalty suspension volumes consistent with the intent of Congress and the DWRRA.

Certainty

Shell believes certainty and stability are necessary for the successful implementation of the Proposed Rule. The complexity, costs and economic risks of deep water exploration and development continue to rise as industry moves into deeper and deeper water. Planning for these investments is a complicated and long-term process that becomes even more difficult and uncertain if the royalty rules are constantly changing. Clearly specifying the royalty relief to be granted in the Notice of Sale and not subjecting that relief volume to change in the future is of paramount importance. We offer the following specific comments:

Volumes. We believe the MMS should offer tracts for lease in water depths greater than 1500 meters with specified royalty suspension volumes. These volumes should be fixed and not subject to change after the fact and should be sufficiently large enough to encourage exploration and development. As indicated earlier, we strongly encourage the MMS to establish additional deep water ranges beyond 1500 meters with increasingly larger royalty suspension volumes with increasing water depth. Consistent with current DWRRA regulations, the deepest water depth of a block should determine the suspension volume for the block.

Price Thresholds. We believe the MMS should maintain the price thresholds of \$28 per barrel of oil and \$3.50 per mcf of gas to be adjusted for inflation after 1995 as is provided in the current DWRRA. Further, we strongly disagree with MMS plans to count oil and gas volumes produced during times when oil and natural gas prices exceed the price thresholds against the royalty suspension volume. Only royalty free production should be counted against the royalty suspension volume.

Term. We believe the three year window proposed by the MMS in the Proposed Rule is adequate to provide the industry with sufficient certainty to plan bidding and acquisition strategies.

Lease-Based Royalty Suspension Volumes

Shell strongly supports the MMS plans to offer across-the-board "lease-based" royalty suspensions as opposed to "field-based" royalty suspensions so long as the suspension volumes are adequate. We believe the "lease-based" approach will provide certainty and stability as well as simplicity of administration.

Bidding Systems

Shell is concerned that the MMS is considering utilizing too many bidding systems and bidding variables that will cause the lease sale process to become overly complicated. We strongly encourage the MMS to avoid unnecessary experimentation with alternative bidding systems. Alternative bidding systems were explored several decades ago, and both the MMS and industry concluded that the current system is preferable. Alternative bidding systems will add uncertainty and additional complexity for both MMS and potential lessees, especially as it impacts minimum bid requirements and economic evaluation of leases. We also question whether having bid

variables with multiple characteristics violates the OCS Lands Act restrictions on multiple bid variables.

One example of an alternative bidding system is sliding scale royalty. Shell presently owns producing leases burdened by a sliding scale royalty. We recommend replacing the sliding scale royalty on such leases with a fixed royalty rate based upon their water depths to improve and simplify the economics of these leases. This action could promote new exploratory drilling on old leases and simplify operations in the event of a discovery.

Financial Terms

Shell is also concerned that the MMS is attempting to recoup some of the royalty revenues lost via royalty suspensions through other means. The intent of royalty suspensions is to provide incentives to marginal opportunities. This intent would be thwarted if other financial burdens or obligations are imposed on the lessee.

Rental or holding fee. The MMS proposal to impose a "rental or holding fee" during periods of royalty suspension is one example of an attempt at such recoupment.

We believe the MMS rationale for assessing a rental or minimum royalty on OCS leases during the period from declaration of producibility to first production is contrary to the ordinary understanding of oil and gas principles. Rentals are due on an OCS lease only when the lease is in non-producing status (see Section 4 of the OCS lease form). Under widely understood OCS practice, a lease is in non-producing status from its date of issuance until the declaration of a producible well has been made under 30 CFR 250.111. Such declaration, according to 30 CFR 250.111, is made at the request of the lessee. Once the declaration of a discovery in paying quantities has been made under 30 CFR 250.111, the OCS lease shifts from the rental phase into minimum royalty phase (see Section 5 of the OCS lease form). Minimum royalty is defined as the difference between "royalty required to be paid with respect to the lease year" and the prescribed minimum royalty for the lease. Under the terms of the lease, since no royalty is due there can be no minimum royalty assessed.

It would be improper for the MMS to promulgate regulatory changes applicable to all OCS leases contrary to this longstanding practice and the specific provisions of the lease under which the blocks were offered. We suggest that the proposed change to Section 218.151 be withdrawn since it will impact all leases and not just deepwater leases with Royalty Suspended volumes. Instead, from this point forward after the rule is finalized, the MMS may find an intent of Congress in the original DWRRA not to suspend minimum royalty/rental during the period of declaration of a producible well and actual production. Therefore, assessment of a minimum royalty on these leases during the royalty suspension period could be imposed as a lease stipulation specifically applicable to any newly issued Royalty Suspended lease.

This practice would not alter a widely understood legal practice and custom and would limit applicability to the source of the problem -- Royalty Suspended leases in this interim phase.

Pugh clause. The introduction of a "Pugh clause" in 30CFR Part 260(b) for the first time in the OCS by charging annual rentals on segregated non-producing portions of producing leases is another example of what appears to be an attempt to recoup revenues lost through royalty suspension. This provision should be clarified to apply only to situations in which a lease is actually broken into two separate leases and assigned a new lease number. It is a longstanding

practice for production to be attributable to all parts of the lease and not just the portion of the lease that has been included in a unit area.

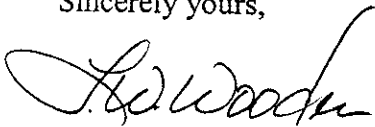
Royalty suspensions and subsequent higher royalty rates. Offering leases with a royalty suspension volume and a subsequent royalty rate higher than 1/8 is yet another example as contemplated in one of the questions posed by the MMS in the proposed rule. We strongly encourage the MMS to provide royalty suspension volumes the agency feels appropriate and leave other financial terms unchanged.

Joint Bidding

Shell's final comments are related to the restricted bidders list. The definition of a person should be clarified so that it does not include affiliate companies for purposes of joint bidding. Further, the proposed rule should be clarified so that agreements between persons on the restricted bidders list may be entered into after the lease sale. As currently worded, the proposed rule would not allow post-lease sale agreements (e.g., unitization, joint development, farm outs, property sales) that are allowed today and are necessary to encourage the efficient development of resources. We encourage the MMS to clarify Section 260.303(d) by inserting after the word "agreement" the words "prior to a lease sale".

Thank you for the opportunity to comment on this important rule. We look forward to working with the MMS in the weeks ahead to finalize the proposed rule in a manner that will benefit the Federal government and industry.

Sincerely yours,



L. W. Wooden
Manager Reputation/Public Affairs

cc: D. A. Lawrence

Shell Oil Company
S. E. Ward